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William A. Bonnet
Vice President
Government & Community Affairs

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September 6, 2007

FILED
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PUBLIC UTILITIES
COMMISSION

The Honorable Chairman and Members of the
Hawaii Public Utilities Commission
465 South King Street
Kekuanaoa Building, First Floor
Honolulu, Hawaii 96813

Dear Commissioners:

CD enclosed

Subject: Docket No. 2006-0386
HECO 2007 Test Year Rate Case - Statement of Probable Entitlement

Enclosed for filing is Hawaiian Electric Company Inc.'s ("HECO" or "Company") Statement of Probable Entitlement for its 2007 test year rate case. HECO respectfully requests the Commission to expeditiously render an Interim Decision and Order for this proceeding. As explained in the Stipulated Settlement Letter, filed September 6, 2007, the Parties in this proceeding – HECO, the Division of Consumer Advocacy of the Department of Commerce and Consumer Affairs ("Consumer Advocate") and the Department of the Navy on behalf of the Department of Defense ("DOD") – agree that the amount of the Interim Rate Increase to which HECO is probably entitled under §269-16(d) of the Hawaii Revised Statutes is \$69,997,000 or 4.96% over revenues at current effective rates¹ (and \$127,293,000 or 9.41% over revenues at present rates²). Exhibit 1 provides the results of operations for revenues at current effective rates, and Exhibit 2 provides the results of operations for revenues at present rates. As indicated in these exhibits, the agreed-upon interim rate increase is based on a return on common equity of 10.7% and a rate of return on rate base of 8.62%.³

¹ Revenues at current effective rates are revenues from base rates plus the interim rate increase approved by the Commission in Interim Decision and Order No. 22050 in HECO's 2005 test year rate case, Docket No. 04-0113, and the interim surcharge for DG trucking and fuel and LSFO trucking authorized in Order No. 23377 in Docket No. 04-0113.

² Revenues at present rates are revenues from base rates, but do not include the interim rate increase and interim surcharge revenues.

³ The Parties also agree that the final rates set in Docket No. 04-0113 may impact revenues at current effective rates and at present rates, and that the amount of the stipulated interim rate increase should be adjusted when the final rates are set to take into account any such changes. Upon issuance of a final decision and order for HECO's 2005 test year rate case (Docket No. 04-0113), the Company will report to the Commission whether any adjustment to the interim rate increase for Docket No. 2006-0386 would be necessary.

THE COMMISSION MAY ISSUE AN INTERIM D&O AT THIS TIME

The Revised Stipulated Procedural Schedule, which the Commission approved in Order No. 23442, specifies November 5, 2007 as the filing date for the Statement of Probable Entitlement. However, the Company is filing its Statement of Probable Entitlement early because the Parties were able to execute a Stipulated Settlement Letter ahead of schedule and filed that document today, September 6, 2007.

Interim rate relief at this time is essential. Under the average test year concept followed in reaching the settlement, the agreed upon increase in revenues is the amount needed at the beginning of the test year to provide a reasonable opportunity to earn the fair rate of return of the test year. The later in the test year that the increase is received, the lower will be the amount of the increase actually received in the test year. In simple terms, if an annual increase of \$70 million is awarded after two-thirds of the 2007 test year has passed (which is the earliest that the interim increase could be made effective), then only approximately one-third of the increase (or \$23.3 million) will actually be received in 2007.

HECO also is concerned about the deterioration in its credit rating, which may make raising capital more expensive and possibly more difficult, especially in the case of preferred stock which is now non-investment grade. Recently in May 2007, Standard and Poor's downgraded HECO's corporate credit, unsecured debt and preferred stock ratings. This comes at a time when capital expenditures are forecast to be relatively high with anticipated increased reliance on outside capital, and when HECO needs to move forward to build the infrastructure necessary to accommodate more renewable energy.

The Commission has ample authority to issue an interim order at this time. For example, in HECO's 1992 test year rate case, Docket No. 6998, the Commission authorized the interim increase after eight months. (Interim Decision and Order No. 11559 was issued March 31, 1992, and HECO's application was filed July 29, 1991.) Moreover, in this case the interim increase would be based on the amount stipulated to by the Parties for purposes of the interim. There are only two remaining contested issues, and the Parties have agreed that an evidentiary hearing is unnecessary. The first issue that impacts revenue requirements, interest synchronization, will be decided based on the Commission's decision in HECO's 2005 test year rate case, Docket No. 04-0113. The second issue, inclusion of the pension asset and related accumulated deferred income taxes in rate base, will be addressed by the Parties in proposed findings of fact and conclusions of law.

As indicated above, the interim increase that HECO is requesting is based on a calculation of probable entitlement that reflects the settlement reached by the Parties on all but two issues affecting revenue requirements. Section 269-16(d) of the Hawaii Revised Statutes ("HRS") explicitly provides that the interim is subject to refund with interest. As a result,



HECO's customers are protected in the event the interim is higher than the final award. The Company is not equally protected if the interim turns out to be lower than the final award. There is no retroactive increase available to the Company under that circumstance.

INTERIM RATE DESIGN

With respect to rate design, the Parties have agreed in the Stipulated Settlement Letter to allocate any interim or final increase in electric revenues to rate classes in the percentages shown in an attachment to the Stipulated Settlement Letter, "HECO T-20, Attachment 1". According to the Stipulated Settlement Letter, this considers the positions of HECO, the Consumer Advocate, and the DOD on cost of service and movement of inter-class revenues towards the respective cost of service positions.

The Parties also have agreed that Schedule P electric revenues established by this allocation will be further adjusted in the following amounts for a stipulated Schedule PP billing credit:⁴ Schedule PP revenues will be decreased by approximately \$2.5 million, Schedule PS revenues will be increased by approximately \$2.2 million, and Schedule PT revenues will be increased by approximately \$0.3 million, as shown in HECO T-20, Attachment 1.

The Parties have agreed that the effect of the stipulated revenue increase allocations, Schedule PP billing credit, and Schedule PS, Schedule PP, and Schedule PT revenue adjustments will be reflected in the approved interim rate increase as follows: Since the interim rate increase will be implemented as a percentage applied to base revenue charges, similar to the implementation of the interim rate increase approved in HECO's test year 2005 rate case, HECO will make the appropriate billing system adjustments to apply a different percentage interim rate increase to Schedule PP customers that are directly served by a dedicated substation and to those that are not, in order to implement the effect of a \$3.25 per kW credit and the stipulated revenue adjustments to Schedule PS, Schedule PP, and Schedule PT.

⁴ Per the Stipulated Settlement Letter, Schedule PP will include a billing credit of \$3.25 per billing kW for customers who are directly served from a dedicated substation. The amount of the credit is an agreed upon value to approximate the reduced level of costs that these customers impose on the HECO system. In the next HECO rate case, HECO has agreed to include in the cost of service and propose in rate design a separate rate class for customers who are directly served from a dedicated substation. The Parties agreed that, to manage the billing impact on Schedule PP customers, the amount of the billing credit above \$1.75 per billing kW (\$1.50 per billing kW or approximately \$2.5 million) will be recovered ratably based on billing kW from Schedule PS and Schedule PT customers.



PENSION AND OPEB TRACKING MECHANISMS

The settlement between HECO, the Consumer Advocate and the DOD includes the establishment of a pension tracking mechanism (as explained in Exhibit 1 and HECO T-10 Attachment 2 of the Stipulated Settlement Letter, filed September 6, 2007) and an OPEB tracking mechanism (as explained in Exhibit 1 of the Stipulated Settlement Letter, filed September 6, 2007, and the June 2007 Update, HECO T-10 Attachment 9, filed June 27, 2007). Therefore, HECO also requests that the Commission approve the adoption of the pension and OPEB tracking mechanisms in its interim decision and order in this proceeding.

For purposes of settlement, the Parties agree to a pension tracking mechanism that does not include the amortization of the pension asset as part of the pension tracking mechanism in this proceeding. Not including the amortization has the effect of deferring the issue of whether the pension asset should be amortized for rate making purposes to HECO's next rate case. In addition, under the tracking mechanism, HECO would only be required to fund the minimum level required under the law, until the existing pension asset amount is reduced to zero, at which time the Company would fund the net periodic pension cost ("NPPC") as specified in the pension tracking mechanism for HELCO.⁵ If the existing pension asset amount is not reduced to zero by the next rate case, the Parties would address the funding requirements for the pension tracking mechanism in the next rate case. Furthermore, the pension tracking mechanism will require the Company to create a regulatory asset or regulatory liability, as appropriate, for the difference between the amount of NPPC included in rates and actual NPPC recorded by the Company.

The Parties also agree to interim rates that incorporate the 2007 Test Year NPPC of \$17,711,000 and the net periodic benefit cost ("NPBC") of \$6,350,000.⁶

⁵ This provision is different from the tracking mechanism that was agreed to for the pending HELCO rate case due to different fact and circumstances. In the HELCO rate case, HELCO and the Consumer Advocate agreed on the inclusion of the pension asset in rate base and the amortization of the pension asset balance at the end of the test year. In the current HECO rate case, the Parties disagree as to whether the pension asset should be included in the test year rate base, as well as whether said balance should be amortized for rate making purposes. The issue as to whether such amortization should be recognized in the test year revenue requirement has been deferred to HECO's next rate case.

⁶ If the pension tracking mechanism is approved by the Commission in the interim, in each future rate case, the cumulative amount of pension cost in rates since the last rate change will be compared to the cumulative amount of the actual NPPC since the rate change, and the difference will be included as a reduction to rate base (if positive, i.e., regulatory liability) or an addition to rate base (if negative, i.e., regulatory asset). The regulatory asset or liability will be included in rate base and amortized over five (5) years at the time of the next rate case.



The Honorable Chairman and Members of the
Hawaii Public Utilities Commission
September 6, 2007
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CONCLUSION

Based on the above, HECO respectfully requests that the Commission approve an interim rate increase in the amount of \$69,997,000 over revenues at current effective rates (and \$127,293,000 over revenues at present rates), approve the rate design for the interim rate increase as described above, and approve the adoption of the pension and OPEB tracking mechanisms in its interim decision and order in this proceeding. For the Commission's consideration, Exhibit 3 provides a proposed interim decision and order for this proceeding.

Very truly yours,



William A. Bonnet
Vice President,
Government & Community Affairs

Enclosures

cc: Division of Consumer Advocacy
Dr. Khojasteh Davoodi
Randall Y.K. Young, Esq.
Sawvel & Associates, Inc.
Utilitech, Inc.
Ralph Smith, Larkin & Associates



Hawaiian Electric Company, Inc.
Probable Entitlement at Current Effective Rates
Results of Operations

	(\$ Thousands)		Revenue Requirements to Produce 8.62% Return on Average Rate Base
	Current Effective Rates	Additional Amount	
Electric Sales Revenue	1,406,573	69,256	1,475,829
Other Operating Revenue	3,384	741	4,125
Gain on Sale of Land	500		500
TOTAL OPERATING REVENUES	1,410,457	69,997	1,480,454
Fuel	543,874		543,874
Purchased Power	387,492		387,492
Production	67,597		67,597
Transmission	10,272		10,272
Distribution	24,663		24,663
Customer Accounts	11,720		11,720
Allowance for Uncoll. Accounts	970	0	970
Customer Service	5,890		5,890
Administration & General	69,189		69,189
Gen Excise Tax Rate Incr Adj	328		328
Operation and Maintenance	1,121,995	0	1,121,995
Depreciation & Amortization	78,763		78,763
Amortization of State ITC	(1,304)		(1,304)
Taxes Other Than Income	131,398	6,200	137,598
Interest on Customer Deposits	377		377
Income Taxes	18,354	24,823	43,177
TOTAL OPERATING EXPENSES	1,349,583	31,023	1,380,606
OPERATING INCOME	60,874	38,974	99,848
AVERAGE RATE BASE	1,159,013	(697)	1,158,316
RATE OF RETURN ON AVERAGE RATE BASE	5.25%		8.62%

Hawaiian Electric Company, Inc.

Probable Entitlement at Current Effective Rates

COMPOSITE EMBEDDED COST OF CAPITAL

Estimated Average

	A	B	C	D
	Capitalization			
	Amount in Thousands	Percent of Total	Earnings Reqmts	Weighted Earnings Reqmts (B) x (C)
Short-Term Debt	38,971	3.08	5.00%	0.154%
Long-Term Debt	480,727	38.01	6.09%	2.314%
Hybrid Securities	27,556	2.18	7.47%	0.163%
Preferred Stock	20,586	1.63	5.51%	0.090%
Common Equity	696,826	55.10	10.70%	5.896%
Total	1,264,666	100.00		
Estimated Composite Cost of Capital				8.617%
			or	<u>8.62%</u>

Probable Entitlement at Current Effective Rates
AVERAGE RATE BASE
(\$ Thousands)

	Beginning Balance	End of Year Balance	Average Balance
Investments in Assets Serving Customers			
Net Cost of Plant in Service	1,331,363	1,370,649	1,351,006
Property Held for Future Use	517	3,567	2,042
Fuel Inventory	53,084	53,084	53,084
Materials & Supplies Inventories	12,838	12,838	12,838
Unamort. Net SFAS 109 Reg. Asset	53,483	55,970	54,727
Pension Asset	0	0	0
OPEB Amount	0	0	0
Unamort Sys Dev Costs	0	4,642	2,321
Unamort DSG Reg Asset	0	0	0
ARO Reg Asset	27	26	27
Total Investments in Assets	1,451,312	1,500,776	1,476,045
Funds From Non-Investors			
Unamortized CIAC	164,092	176,802	170,447
Customer Advances	1,001	756	879
Customer Deposits	6,369	6,827	6,598
Accumulated Def. Income Taxes	135,254	130,294	132,774
Unamort State ITC (Gross)	28,523	30,044	29,284
Unamortized Gain on Sale	1,582	1,214	1,398
Total Deductions	336,821	345,937	341,380
Difference			1,134,665
Working Cash at Current Effective Rates			24,348
Rate Base at Current Effective Rates			1,159,013
Change in Rate Base - Working Cash			(697)
Rate Base at Proposed Rates			1,158,316

Hawaiian Electric Company, Inc.

Probable Entitlement at Current Effective Rates
WORKING CASH ITEMS

(\$ Thousands)

	A	B	C	D
	COLLECTION	PAYMENT	NET	
	LAG	LAG	COLLECTION	
	(DAYS)	(DAYS)	LAG	ANNUAL
			(DAYS)	AMOUNT
			(A - B)	
ITEMS REQUIRING WORKING CASH				
Fuel Oil Purchases	37	17	20	537,767
O&M Labor	37	11	26	88,209
O&M Nonlabor	37	34	3	100,922
Pension Asset Amortization	37	0	37	-
ITEMS THAT PROVIDE WORKING CASH				
Revenue Taxes	37	66	(29)	125,104
Income Taxes-Present Rates	37	40	(3)	20,489
Income Taxes-Proposed Rates	37	40	(3)	45,312
Purchased Power	37	39	(2)	387,492
	E	F	G	H
	AVERAGE	WORKING	AVERAGE	WORKING
	DAILY	CASH	DAILY	CASH
	AMOUNT	(PRESENT	AMOUNT	(PROPOSED
	(D/365)	RATES)	(PROPOSED)	RATES)
		(C X E)		(C X G)
ITEMS REQUIRING WORKING CASH				
Fuel Oil Purchases	1,473	29,467	1,473	29,467
O&M Labor	242	6,283	242	6,283
O&M Nonlabor	276	829	276	829
Pension Asset Amortization	0	0	0	0
ITEMS THAT PROVIDE WORKING CASH				
Purchased Power	1,062	(2,123)	1,062	(2,123)
Revenue Taxes	343	(9,940)	360	(10,432)
Income Taxes-Present Rates	56	(168)		
Income Taxes-Proposed Rates	124	-	124	(372)
Total		24,348		23,652
Change in Working Cash				(696)

Hawaiian Electric Company, Inc.

Probable Entitlement at Current Effective Rates
COMPUTATION OF INCOME TAX EXPENSE

(\$ Thousands)

	Current Effective Rates	Adjustment	At Proposed Rates
Operating Revenues	1,410,457	69,997	1,480,454
Operating Expenses:			
Fuel Oil and Purchased Power	931,366		931,366
Other Operation & Maintenance Expense	190,629	0	190,629
Depreciation	78,763		78,763
Amortization of State ITC	(1,304)		(1,304)
Taxes Other than Income	131,398	6,200	137,598
Interest on Customer Deposits	377		377
Total Operating Expenses	1,331,229	6,200	1,337,429
Operating Income Before Income Taxes	79,228	63,797	143,025
Tax Adjustments:			
Interest Expense	(30,597)		(30,597)
Meals and Entertainment	81		81
	(30,516)	0	(30,516)
Taxable Income at Ordinary Rates	48,712	63,797	112,509
Income Tax Exp at Ordinary Rates	18,954	24,823	43,777
Tax Benefit of Domestic Production Activities Deduction	577		577
Tax Effect of Deductible Preferred Stock Dividends	23		23
TOTAL INCOME TAX EXPENSE	18,354	24,823	43,177

DPAD is not applicable to current effective rates; however, it is shown here to facilitate the proper calculation of revenue requirements.

Hawaiian Electric Company, Inc.

Probable Entitlement at Current Effective Rates
COMPUTATION OF TAXES OTHER THAN INCOME TAX

(\$ Thousands)

	Rate	At Curr Eff Rates	Adjustment	At Proposed Rates
Electric Sales Revenue		1,406,573	69,256	1,475,829
Other Operating Revenue		3,384	741	4,125
Operating Revenues		1,409,957	69,997	1,479,954
Public Service Tax	5.885%	82,919	4,119	87,038
PUC Fees	0.500%	7,045	350	7,395
Franchise Tax	2.500%	35,140	1,731	36,871
Payroll Tax		6,294		6,294
TOTAL TAXES OTHER THAN INCOME TAX		131,398	6,200	137,598

Hawaiian Electric Company, Inc.

Probable Entitlement at Current Effective Rates
CALCULATIONS OF REVENUE REQUIREMENTS

(\$ Thousands)

OPERATING INCOME AT CURRENT EFFECTIVE RATES:

Operating Revenues	1,410,457
Fuel and Purchased Power Expenses	931,366
Other O&M Expenses	190,629
Depreciation & Amortization Expense	78,763
Amortization of State ITC	(1,304)
Taxes Other than Income	131,398
Interest on Customer Deposits	377
Income Taxes	18,354
Total Operating Expenses	1,349,583

OPERATING INCOME AT CURRENT EFFECTIVE RATES 60,874

CALCULATIONS OF REVENUE REQUIREMENTS:

OPERATING INCOME

Rate Base at Proposed Rates	1,158,316
Proposed Rate of Return on Rate Base	x 8.62%
Operating Income	99,847

Less: Operating Income at Current Effective Rate 60,874

INCREASE IN OPERATING INCOME 38,973

OPERATING REVENUES:

Increase in Operating Income	38,973
Operating Income Divisor (divided by)	0.55679

INCREASE IN OPERATING REVENUES 69,997

Increase in Electric Sales Revenue	69,256
Other Operating Revenue Rate	x 1.070%
Increase in Other Operating Revenues	741
	<u>69,997</u>

Hawaiian Electric Company, Inc.

Probable Entitlement at Current Effective Rates
CALCULATIONS OF REVENUE REQUIREMENTS

(\$ Thousands)

BAD DEBT:		
Increase in Electric Revenues		69,256
Bad Debt Rate	x	0.0000
		<hr/>
INCREASE IN BAD DEBT EXPENSE		0
		<hr/>
REVENUE TAX:		
Increase in Operating Revenues		69,997
Less: Increase in Bad Debt Expense		0
		<hr/>
		69,997
PSC Tax & PUC Fees Rate	x	6.385%
		<hr/>
		4,469
		<hr/>
Increase in Electric Revenues		69,256
Less: Increase in Bad Debt Expense		0
		<hr/>
		69,256
Franchise Tax Rate	x	2.500%
		<hr/>
		1,731
		<hr/>
INCREASE IN REVENUE TAX		6,200
		<hr/>
INCOME TAX:		
Increase in Operating Revenues		69,997
Effective Income Tax Rate after considering revenue tax & bad debt	x	35.463%
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INCREASE IN INCOME TAX		24,823
		<hr/>
INCREASE IN OPERATING INCOME (check)		38,974
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Hawaiian Electric Company, Inc.

Probable Entitlement at Current Effective Rates
CALCULATIONS OF REVENUE REQUIREMENTS

(\$ Thousands)

CHANGE IN RATE BASE:

	A	B	C	D
	EXPENSE	AVERAGE	NET	WORKING
	AMOUNT	DAILY	COLLECTION	CASH
		AMOUNT	LAG (DAYS)	REQMT
		(A/365)		(B) x (C)
Increase in Revenue Tax	6,200	17	(29)	(493)
Income Tax at present rates	20,489	56	(3)	168
Income Tax at proposed rate	45,312	124	(3)	(372)
CHANGE IN RATE BASE - WORKING CASH				(697)
Rate Base at Present Rates				1,159,013
PROPOSED RATE BASE				1,158,316
Operating Income at Present Rates				60,874
Increase in Operating Income				38,973
OPERATING INCOME AT PROPOSED RATES				99,847
PROPOSED RATE OF RETURN ON RATE BASE (check)				8.62%

Hawaiian Electric Company, Inc.

Probable Entitlement at Current Effective Rates
SUPPORT WORKSHEET

OPERATING REVENUES:

Electric Sales Revenues	1,406,573
Other Operating Revenues	3,384
Gain on Sale of Land	500

TOTAL OPERATING REVENUES	<u>1,410,457</u>
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FUEL OIL AND PURCHASE POWER EXPENSES:

Fuel Oil Expense	537,767
Fuel Related Non-labor Exp	5,207
Fuel Handling Labor Expense	900

Fuel Oil Expense	<u>543,874</u>
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Purchased Power Expense	<u>387,492</u>
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TOTAL FUEL OIL AND PURCHASE POWER EXPENSES	<u>931,366</u>
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OTHER OPERATION & MAINTENANCE EXPENSES:

Production	67,597
Transmission	10,272
Distribution	24,663
Customer Account	11,720
Allowance for Uncollectible Accounts	970
Customer Service	5,890
Administration & General	69,189
Gen Excise Tax Rate Incr Adj	328

TOTAL OTHER OPERATION & MAINTENANCE EXPENSES	<u>190,629</u>
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Hawaiian Electric Company, Inc.

Probable Entitlement at Current Effective Rates
SUPPORT WORKSHEET

TOTAL FUEL OIL & PP AND OTH O&M EXPENSES (LABOR/NONLABOR)	
Fuel Oil Expense	537,767
Purchase Power Expense	387,492
Total Labor Expense	
Labor Expense	88,209
Total Labor Expense	<u>88,209</u>
Total Nonlabor Expense	
Nonlabor Expense	103,320
Fuel Related Expense	5,207
Payroll Taxes	6,294
Bad Debt Expense	(970)
Pension Expense	(12,929)
Pension Asset Amortization	0
	<u>100,922</u>
TOTAL FUEL OIL & PP, OTH O&M AND PR TAX EXPENSES	<u>1,114,390</u>
REVENUE TAX	
Public Service Tax	
Electric Sales Revenues	1,406,573
Other Operating Revenues	3,384
Less: Bad Debt Expense	(970)
Operating Revenues subject to PSC Tax	1,408,987
Public Service Tax Rate	x 5.885%
Total PSC Tax	<u>82,919</u>
PUC Fees	
Electric Sales Revenues	1,406,573
Other Operating Revenues	3,384
Less: Bad Debt Expense	(970)
Operating Revenues subject to PSC Tax	1,408,987
PUC Tax Rate	x 0.500%
Total PUC Tax	<u>7,045</u>

Hawaiian Electric Company, Inc.

Probable Entitlement at Current Effective Rates
SUPPORT WORKSHEET

Franchise Tax		
Electric Sales Revenues		1,406,573
Less: Bad Debt Expense		(970)
		<u>1,405,603</u>
Franchise Tax Rate	x	<u>2.500%</u>
Total Franchise Tax		<u>35,140</u>
TOTAL REVENUE TAX		<u>125,104</u>
INTEREST EXPENSE:		
Interest Charged to Operations		33,275
AFUDC Debt		(2,678)
TOTAL INTEREST EXPENSE		<u>30,597</u>
INCOME TAX EXPENSE SUMMARY		
Current		20,489
Deferred		(4,960)
State ITC		2,825
Pension Asset Amortization		0
TOTAL INCOME TAX EXPENSE		<u>18,354</u>
CALCULATIONS OF REVENUE TAX RATE:		
Franchise Tax Rate adjusted for Change in Oth Oper		
Revenues and Bad Debt		0.02473
PSC Tax Rate adjusted for Bad Debt		0.05885
PUC Tax Rate adjusted for Bad Debt		<u>0.00500</u>
REVENUE TAX RATE		<u>0.08858</u>
CALCULATIONS OF COMPOSITE INCOME TAX RATE:		
State Tax Rate		0.06015
Federal Tax Rate		0.35000
State Tax Rate		0.06015
Federal Tax Rate	x	<u>0.35000</u>
Federal Tax Effect on State Tax		<u>(0.02105)</u>
COMPOSITE INCOME TAX RATE		<u>0.38910</u>

Hawaiian Electric Company, Inc.

Probable Entitlement at Current Effective Rates
SUPPORT WORKSHEET

CALCULATIONS OF COMPOSITE CAPITAL GAINS TAX RATE:

State Capital Gains Tax Rate		0.03759
Federal Tax Rate		0.35000
State Capital Gains Tax Rate		0.03759
Federal Tax Rate	x	0.35000
Federal Tax Effect on State Capital Gains Tax Rate		(0.01316)
COMPOSITE CAPITAL GAINS TAX RATE		<u>0.37444</u>

CALCULATIONS OF EFFECTIVE INCOME TAX RATE:

PSC Tax & PUC Fees Rates adjusted for Bad Debt		0.06385
Franchise Tax adjusted for Change in Oth Oper Rev and Bad Debt		0.02473
Bad Debt Rate adjusted for Change in Oth Oper Rev		-
Revenue Tax and Bad Debt rate		<u>0.08858</u>
Rev Tax & Bad Debt Reciprocal	(1 - 0.08858)	0.91142
Composite Income Tax Rate	x	<u>0.38910</u>
EFFECTIVE INCOME TAX RATE AFTER CONSIDERING REVENUE TAX & BAD DEBT		<u>0.35463</u>

CALCULATIONS OF OPERATING INCOME DIVISOR:

PSC Tax & PUC Fees Rates		0.06385
Franchise Tax adjusted for Change in Oth Oper Rev		0.02473
Bad Debt Rate adjusted for Change in Oth Oper Rev		-
Effective Income Tax Rate after considering revenue tax & bad debt		<u>0.35463</u>
		<u>0.44321</u>
OPERATING INCOME DIVISOR	(1 - 0.44321)	<u>0.55679</u>

Hawaiian Electric Company, Inc.
Probable Entitlement at Present Rates
Results of Operations

	(\$ Thousands)		Revenue Requirements to Produce 8.62% Return on Average Rate Base
	Present Rates	Additional Amount	
Electric Sales Revenue	1,349,330	126,498	1,475,828
Other Operating Revenue	3,329	795	4,124
Gain on Sale of Land	500		500
TOTAL OPERATING REVENUES	1,353,159	127,293	1,480,452
Fuel	543,874		543,874
Purchased Power	387,492		387,492
Production	67,597		67,597
Transmission	10,272		10,272
Distribution	24,663		24,663
Customer Accounts	11,720		11,720
Allowance for Uncoll. Accounts	970	0	970
Customer Service	5,890		5,890
Administration & General	69,189		69,189
Gen Excise Tax Rate Incr Adj	328		328
Operation and Maintenance	1,121,995	0	1,121,995
Depreciation & Amortization	78,763		78,763
Amortization of State ITC	(1,304)		(1,304)
Taxes Other Than Income	126,308	11,289	137,597
Interest on Customer Deposits	377		377
Income Taxes	(1,960)	45,136	43,176
TOTAL OPERATING EXPENSES	1,324,179	56,425	1,380,604
OPERATING INCOME	28,980	70,868	99,848
AVERAGE RATE BASE	1,159,585	(1,268)	1,158,317
RATE OF RETURN ON AVERAGE RATE BASE	2.50%		8.62%

Hawaiian Electric Company, Inc.

Probable Entitlement at Present Rates

COMPOSITE EMBEDDED COST OF CAPITAL

Estimated Average

	A	B	C	D
	Capitalization			
	Amount in Thousands	Percent of Total	Earnings Reqmts	Weighted Earnings Reqmts (B) x (C)
Short-Term Debt	38,971	3.08	5.00%	0.154%
Long-Term Debt	480,727	38.01	6.09%	2.314%
Hybrid Securities	27,556	2.18	7.47%	0.163%
Preferred Stock	20,586	1.63	5.51%	0.090%
Common Equity	696,826	55.10	10.70%	5.896%
Total	1,264,666	100.00		
Estimated Composite Cost of Capital				8.617%
			or	<u>8.62%</u>

Hawaiian Electric Company, Inc.

Probable Entitlement at Present Rates
AVERAGE RATE BASE
(\$ Thousands)

	Beginning Balance	End of Year Balance	Average Balance
Investments in Assets Serving Customers			
Net Cost of Plant in Service	1,331,363	1,370,649	1,351,006
Property Held for Future Use	517	3,567	2,042
Fuel Inventory	53,084	53,084	53,084
Materials & Supplies Inventories	12,838	12,838	12,838
Unamort. Net SFAS 109 Reg. Asset	53,483	55,970	54,727
Pension Asset	0	0	0
OPEB Amount	0	0	0
Unamort Sys Dev Costs	0	4,642	2,321
Unamort DSG Reg Asset	0	0	0
ARO Reg Asset	27	26	27
Total Investments in Assets	1,451,312	1,500,776	1,476,045
Funds From Non-Investors			
Unamortized CIAC	164,092	176,802	170,447
Customer Advances	1,001	756	879
Customer Deposits	6,369	6,827	6,598
Accumulated Def. Income Taxes	135,254	130,294	132,774
Unamort State ITC (Gross)	28,523	30,044	29,284
Unamortized Gain on Sale	1,582	1,214	1,398
Total Deductions	336,821	345,937	341,380
Difference			1,134,665
Working Cash at Present Rates			24,920
Rate Base at Present Rates			1,159,585
Change in Rate Base - Working Cash			(1,268)
Rate Base at Proposed Rates			1,158,317

Hawaiian Electric Company, Inc.

Probable Entitlement at Present Rates
WORKING CASH ITEMS

(\$ Thousands)

	A	B	C	D
	COLLECTION	PAYMENT	NET	
	LAG	LAG	COLLECTION	
	(DAYS)	(DAYS)	LAG	ANNUAL
			(DAYS)	AMOUNT
			(A - B)	
ITEMS REQUIRING WORKING CASH				
Fuel Oil Purchases	37	17	20	537,767
O&M Labor	37	11	26	88,209
O&M Nonlabor	37	34	3	100,922
Pension Asset Amortization	37	0	37	-
ITEMS THAT PROVIDE WORKING CASH				
Purchased Power	37	39	(2)	387,492
Revenue Taxes	37	66	(29)	120,014
Income Taxes-Present Rates	37	40	(3)	175
Income Taxes-Proposed Rates	37	40	(3)	45,311
	E	F	G	H
	AVERAGE	WORKING	AVERAGE	WORKING
	DAILY	CASH	DAILY	CASH
	AMOUNT	(PRESENT	AMOUNT	(PROPOSED
	(D/365)	RATES)	(PROPOSED)	RATES)
		(C X E)		(C X G)
ITEMS REQUIRING WORKING CASH				
Fuel Oil Purchases	1,473	29,467	1,473	29,467
O&M Labor	242	6,283	242	6,283
O&M Nonlabor	276	829	276	829
Pension Asset Amortization	0	0	0	0
ITEMS THAT PROVIDE WORKING CASH				
Purchased Power	1,062	(2,123)	1,062	(2,123)
Revenue Taxes	329	(9,535)	360	(10,432)
Income Taxes-Present Rates	0	(1)		
Income Taxes-Proposed Rates	124	-	124	(372)
Total		24,920		23,652
Change in Working Cash				(1,268)

Hawaiian Electric Company, Inc.

Probable Entitlement at Present Rates
COMPUTATION OF INCOME TAX EXPENSE

(\$ Thousands)

	Present Rates	Adjustment	At Proposed Rates
Operating Revenues	1,353,159	127,293	1,480,452
Operating Expenses:			
Fuel Oil and Purchased Power	931,366		931,366
Other Operation & Maintenance Expense	190,629	0	190,629
Depreciation	78,763		78,763
Amortization of State ITC	(1,304)		(1,304)
Taxes Other than Income	126,308	11,289	137,597
Interest on Customer Deposits	377		377
Total Operating Expenses	1,326,139	11,289	1,337,428
Operating Income Before Income Taxes	27,020	116,004	143,024
Tax Adjustments:			
Interest Expense	(30,597)		(30,597)
Meals and Entertainment	81		81
	(30,516)	0	(30,516)
Taxable Income at Ordinary Rates	(3,496)	116,004	112,508
Income Tax Exp at Ordinary Rates	(1,360)	45,137	43,777
Tax Benefit of Domestic Production Activities Deduction	577		577
Tax Effect of Deductible Preferred Stock Dividends	23		23
TOTAL INCOME TAX EXPENSE	(1,960)	45,137	43,177

DPAD is not applicable to present rates; however, it is shown here to facilitate the proper calculation of revenue requirements.

Hawaiian Electric Company, Inc.

Probable Entitlement at Present Rates
COMPUTATION OF TAXES OTHER THAN INCOME TAX

(\$ Thousands)

	Rate	At Present Rates	Adjustment	At Proposed Rates
Electric Sales Revenue		1,349,330	126,498	1,475,828
Other Operating Revenue		3,329	795	4,124
Operating Revenues		1,352,659	127,293	1,479,952
Public Service Tax	5.885%	79,547	7,491	87,038
PUC Fees	0.500%	6,758	636	7,394
Franchise Tax	2.500%	33,709	3,162	36,871
Payroll Tax		6,294		6,294
TOTAL TAXES OTHER THAN INCOME TAX		126,308	11,289	137,597

Hawaiian Electric Company, Inc.

Probable Entitlement at Present Rates
CALCULATIONS OF REVENUE REQUIREMENTS

(\$ Thousands)

OPERATING INCOME AT PRESENT RATES:

Operating Revenues	1,353,159
Fuel and Purchased Power Expenses	931,366
Other O&M Expenses	190,629
Depreciation & Amortization Expense	78,763
Amortization of State ITC	(1,304)
Taxes Other than Income	126,308
Interest on Customer Deposits	377
Income Taxes	(1,960)
Total Operating Expenses	1,324,179

OPERATING INCOME AT PRESENT RATES	28,980
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CALCULATIONS OF REVENUE REQUIREMENTS:

OPERATING INCOME

Rate Base at Proposed Rates	1,158,317
Proposed Rate of Return on Rate Base	x 8.62%
Operating Income	99,847

Less: Operating Income at Present Rates	28,980
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INCREASE IN OPERATING INCOME	70,867
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OPERATING REVENUES:

Increase in Operating Income	70,867
Operating Income Divisor (divided by)	0.55672

INCREASE IN OPERATING REVENUES	127,293
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Increase in Electric Sales Revenue	126,498
Other Operating Revenue Rate	x 0.628%
Increase in Other Operating Revenues	795
	127,293

Hawaiian Electric Company, Inc.

Probable Entitlement at Present Rates
CALCULATIONS OF REVENUE REQUIREMENTS

(\$ Thousands)

BAD DEBT:		
Increase in Electric Revenues		126,498
Bad Debt Rate	x	0.0000
		<hr/>
INCREASE IN BAD DEBT EXPENSE		0
		<hr/>
REVENUE TAX:		
Increase in Operating Revenues		127,293
Less: Increase in Bad Debt Expense		0
		<hr/>
		127,293
PSC Tax & PUC Fees Rate	x	6.385%
		<hr/>
		8,127
		<hr/>
Increase in Electric Revenues		126,498
Less: Increase in Bad Debt Expense		0
		<hr/>
		126,498
Franchise Tax Rate	x	2.500%
		<hr/>
		3,162
		<hr/>
INCREASE IN REVENUE TAX		11,289
		<hr/>
INCOME TAX:		
Increase in Operating Revenues		127,293
Effective Income Tax Rate after considering revenue tax & bad debt	x	35.459%
		<hr/>
INCREASE IN INCOME TAX		45,136
		<hr/>
INCREASE IN OPERATING INCOME (check)		70,868
		<hr/>

Hawaiian Electric Company, Inc.

Probable Entitlement at Present Rates
CALCULATIONS OF REVENUE REQUIREMENTS

(\$ Thousands)

CHANGE IN RATE BASE:

	A	B	C	D
	EXPENSE	AVERAGE	NET	WORKING
	AMOUNT	DAILY	COLLECTION	CASH
		AMOUNT	LAG (DAYS)	REQMT
		(A/365)		(B) x (C)
Increase in Revenue Tax	11,289	31	(29)	(897)
Income Tax at present rates	175	0	(3)	1
Income Tax at proposed rate	45,311	124	(3)	(372)
CHANGE IN RATE BASE - WORKING CASH				(1,268)
Rate Base at Present Rates				1,159,585
PROPOSED RATE BASE				1,158,317
Operating Income at Present Rates				28,980
Increase in Operating Income				70,867
OPERATING INCOME AT PROPOSED RATES				99,847
PROPOSED RATE OF RETURN ON RATE BASE (check)				8.62%

Hawaiian Electric Company, Inc.

Probable Entitlement at Present Rates
SUPPORT WORKSHEET

OPERATING REVENUES:

Electric Sales Revenues	1,349,330
Other Operating Revenues	3,329
Gain on Sale of Land	500

TOTAL OPERATING REVENUES	<u>1,353,159</u>
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FUEL OIL AND PURCHASE POWER EXPENSES:

Fuel Oil Expense	537,767
Fuel Related Non-labor Exp	5,207
Fuel Handling Labor Expense	900

Fuel Oil Expense	<u>543,874</u>
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Purchased Power Expense	<u>387,492</u>
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TOTAL FUEL OIL AND PURCHASE POWER EXPENSES	<u>931,366</u>
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OTHER OPERATION & MAINTENANCE EXPENSES:

Production	67,597
Transmission	10,272
Distribution	24,663
Customer Account	11,720
Allowance for Uncollectible Accounts	970
Customer Service	5,890
Administration & General	69,189
Gen Excise Tax Rate Incr Adj	328

TOTAL OTHER OPERATION & MAINTENANCE EXPENSES	<u>190,629</u>
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Hawaiian Electric Company, Inc.

Probable Entitlement at Present Rates
SUPPORT WORKSHEET

TOTAL FUEL OIL & PP AND OTH O&M EXPENSES (LABOR/NONLABOR)	
Fuel Oil Expense	537,767
Purchase Power Expense	387,492
Total Labor Expense	
Labor Expense	88,209
Total Labor Expense	<u>88,209</u>
Total Nonlabor Expense	
Nonlabor Expense	103,320
Fuel Related Expense	5,207
Payroll Taxes	6,294
Bad Debt Expense	(970)
Pension Expense	(12,929)
Pension Asset Amortization	0
	<u>100,922</u>
TOTAL FUEL OIL & PP, OTH O&M AND PR TAX EXPENSES	<u>1,114,390</u>
REVENUE TAX	
Public Service Tax	
Electric Sales Revenues	1,349,330
Other Operating Revenues	3,329
Less: Bad Debt Expense	(970)
Operating Revenues subject to PSC Tax	<u>1,351,689</u>
Public Service Tax Rate	x 5.885%
Total PSC Tax	<u>79,547</u>
PUC Fees	
Electric Sales Revenues	1,349,330
Other Operating Revenues	3,329
Less: Bad Debt Expense	(970)
Operating Revenues subject to PSC Tax	<u>1,351,689</u>
PUC Tax Rate	x 0.500%
Total PUC Tax	<u>6,758</u>

Hawaiian Electric Company, Inc.

Probable Entitlement at Present Rates
SUPPORT WORKSHEET

Franchise Tax		
Electric Sales Revenues		1,349,330
Less: Bad Debt Expense		(970)
		<u>1,348,360</u>
Franchise Tax Rate	x	<u>2.500%</u>
Total Franchise Tax		<u>33,709</u>
TOTAL REVENUE TAX		<u>120,014</u>
INTEREST EXPENSE:		
Interest Charged to Operations		33,275
AFUDC Debt		(2,678)
		<u>30,597</u>
TOTAL INTEREST EXPENSE		<u>30,597</u>
INCOME TAX EXPENSE SUMMARY		
Current		175
Deferred		(4,960)
State ITC		2,825
Pension Asset Amortization		0
		<u>(1,960)</u>
TOTAL INCOME TAX EXPENSE		<u>(1,960)</u>
CALCULATIONS OF REVENUE TAX RATE:		
Franchise Tax Rate adjusted for Change in Oth Oper		
Revenues and Bad Debt		0.02484
PSC Tax Rate adjusted for Bad Debt		0.05885
PUC Tax Rate adjusted for Bad Debt		<u>0.00500</u>
REVENUE TAX RATE		<u>0.08869</u>
CALCULATIONS OF COMPOSITE INCOME TAX RATE:		
State Tax Rate		0.06015
Federal Tax Rate		0.35000
State Tax Rate		0.06015
Federal Tax Rate	x	<u>0.35000</u>
Federal Tax Effect on State Tax		<u>(0.02105)</u>
COMPOSITE INCOME TAX RATE		<u>0.38910</u>

Hawaiian Electric Company, Inc.

Probable Entitlement at Present Rates
SUPPORT WORKSHEET

CALCULATIONS OF COMPOSITE CAPITAL GAINS TAX RATE:

State Capital Gains Tax Rate		0.03759
Federal Tax Rate		0.35000
State Capital Gains Tax Rate		0.03759
Federal Tax Rate	x	0.35000
Federal Tax Effect on State Capital Gains Tax Rate		(0.01316)
COMPOSITE CAPITAL GAINS TAX RATE		<u>0.37444</u>

CALCULATIONS OF EFFECTIVE INCOME TAX RATE:

PSC Tax & PUC Fees Rates adjusted for Bad Debt		0.06385
Franchise Tax adjusted for Change in Oth Oper Rev and Bad Debt		0.02484
Bad Debt Rate adjusted for Change in Oth Oper Rev		-
Revenue Tax and Bad Debt rate		<u>0.08869</u>
Rev Tax & Bad Debt Reciprocal	(1 - 0.08869)	0.91131
Composite Income Tax Rate	x	<u>0.38910</u>
EFFECTIVE INCOME TAX RATE AFTER CONSIDERING REVENUE TAX & BAD DEBT		<u>0.35459</u>

CALCULATIONS OF OPERATING INCOME DIVISOR:

PSC Tax & PUC Fees Rates		0.06385
Franchise Tax adjusted for Change in Oth Oper Rev		0.02484
Bad Debt Rate adjusted for Change in Oth Oper Rev		-
Effective Income Tax Rate after considering revenue tax & bad debt		<u>0.35459</u>
		<u>0.44328</u>
OPERATING INCOME DIVISOR	(1 - 0.44328)	<u>0.55672</u>

DOCKET NO. 2006-0386
HECO 2007 TEST YEAR RATE CASE

PROPOSED DECISION AND ORDER

By this Interim Decision and Order, the commission approves, on an interim basis, the request of HAWAIIAN ELECTRIC COMPANY, INC. ("HECO") to increase its rates to such levels as will produce, in the aggregate, \$69,997,000 in additional revenues, or 4.96 per cent over revenues at current effective rates for a normalized 2007 test year ("2007 Test Year").

The commission also approves, on an interim basis, the adoption of the pension and Postretirement Benefits Other Than Pensions ("OPEB") tracking mechanisms, and interim rates that incorporate the test year net periodic pension costs ("NPPC") of \$17,711,000, and the test year net periodic benefit costs ("NPBC") of \$6,350,000, to be described herein.

I.

Introduction

A.

Application

On December 22, 2006, HECO filed an application for approval of rate increases and revised rate schedules and rules in which HECO requested a general rate increase of approximately \$99,556,000, or 7.1%, over revenues at current effective rates. HECO's filing included its Direct Testimonies, Exhibits and Workpapers.¹ HECO filed its Application pursuant to HAR Title 6, Chapter 61, Subchapters 2, 6, and 8, Rules of Practice and Procedure before the Public Utilities Commission. HECO seeks the commission's approval of the proposed rate increase and revised rate schedules pursuant to Hawaii Revised Statutes ("HRS") §269-16.

HECO served copies of the Application on the DIVISION OF CONSUMER ADVOCACY, DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS ("Consumer Advocate"), an *ex officio* party to this docket, pursuant to HRS § 269-51 and HAR § 6-61-62.

By Order No. 23262, filed on February 15, 2007, the commission found that the application was complete and properly filed under HRS §269-16(d) and Hawaii Administrative Rules ("HAR") §6-61-87. Thus, the filing date of HECO's completed Application is December 22, 2006.

¹ HECO's Application and Certificate of Service, filed on December 22, 2006 ("Application"). On September 22, 2006, HECO filed a Notice of Intent, pursuant to Hawaii Administrative Rules ("HAR") §6-61-85, stating that it planned to request rate relief based on a 2007 calendar year test period and file an application on or after November 22, 2006.

On March 6, 2007, the commission held a public hearing on the Application at the Prince David Kawanakoa Middle School Cafeteria in Honolulu, Hawaii, to gather public comments on this docket.

On April 5, 2007, HECO and the Consumer Advocate filed a Stipulated Procedural Schedule in this docket, pursuant to Order No. 23262, filed on February 15, 2007.

By Order No. 23366, filed on April 13, 2007, the commission granted the Motion to Intervene and Become a Party filed by the DOD on February 20, 2007, and denied the Motion to Intervene filed by Life of the Land on January 5, 2007.

Given the DOD's intervention in this docket, by letter dated April 23, 2007, the commission instructed HECO, the Consumer Advocate, and DOD to re-submit a Stipulated Procedural Schedule that incorporates DOD into the procedural schedule of this proceeding. On May 4, 2007, the Parties filed a Revised Stipulated Procedural Schedule, which the commission approved by Order No. 23442, filed on May 17, 2007.

On April 23, 2007, the commission also issued Protective Order No. 23378 to govern the classification, acquisition and use of confidential information by any party in this docket.²

During the period from February through July 2007, HECO responded to information requests ("IRs") submitted by the Consumer Advocate and the DOD. In June and July 2007, HECO also submitted updates to its 2007 test year estimates reflected in the Application, Direct Testimonies, Exhibits and Workpapers filed on December 22, 2006, including incorporation of certain recorded 2006 results as well as other corrections and revisions.

The Consumer Advocate and DOD's Testimonies, Exhibits and Workpapers were filed on August 6, 2007, and reflected rate increases of \$53,550,000, and \$54,959,000, respectively. HECO has submitted a number of IRs to the other parties.

By Order No. 23612, filed August 24, 2007, the commission approved the Stipulated Prehearing Order submitted by the Parties on July 23, 2007, with modifications, and amended the Parties' stipulated procedural schedule, approved in Order No. 23442, filed May 17, 2007.

B.

Stipulated Settlement Letter

Order Nos. 23442 and 23612 govern the proceedings in this docket. Pursuant thereto, the Parties engaged in settlement discussions, in an attempt to resolve the issues established for this docket. By Stipulated Settlement Letter filed on September 6, 2007, the Parties documented their agreements on all but two issues impacting revenue requirements: (1) whether the Company's pension asset should be included in rate base,³

² On June 4, 2007, the commission issued Amended Protective Order No. 23378, which revised the protective order to include the DOD.

³ HECO proposed to include \$59,405,000 of pension asset in the test year average rate base. The portion of the Accumulated Deferred Income Taxes ("ADIT") related to the pension asset amounts to \$23,114,000. The Parties agreed that the exclusion of all or a portion of the pension asset in rate base will also require corresponding adjustment to ADIT. The Consumer Advocate and the DOD oppose the

and (2) whether interest synchronization should be used to determine the interest expense deduction for computing the test year income tax expense.⁴ The Parties agree that these issues need not be addressed in an evidentiary hearing and that the Parties may file proposed findings of fact and conclusions of law⁵ on the pension asset issue only.⁶

As a result of the settlement reached between Hawaii Electric Light Company, Inc. ("HELCO") and the Consumer Advocate regarding the implementation of a pension tracking mechanism for HELCO in Docket No. 05-0315 (HELCO's 2006 test year rate case), HECO proposed a pension tracking mechanism in the instant proceeding. (See June 2007 Update HECO T-10 Attachment 8, filed on June 27, 2007.)

For purposes of settlement, the Parties have agreed to a pension tracking mechanism that does not include the amortization of the pension asset as part of the pension tracking mechanism in this proceeding. Not including the amortization has the effect of deferring the issue of whether the pension asset should be amortized for rate making purposes to HECO's next rate case.⁷ The pension tracking mechanism will

inclusion of HECO's pension asset in rate base. Whether a pension asset should be included in rate base also is an issue in HECO's 2005 test year rate case (Docket No. 04-0113). For purposes of an interim decision in this proceeding, the Parties agree to exclude the pension asset and related ADIT from rate base.

⁴ The DOD proposed an adjustment for interest synchronization to determine the interest deduction for the calculation of test year income tax expense. HECO did not agree with this proposal and did not use interest synchronization to develop its revenue requirements for the test year. The Parties took the same positions in Docket No. 04-0113 (HECO 2005 test year rate case). For purposes of settlement, the Parties agreed to not relitigate the issue in this docket, that HECO's method of computing interest expense for the purposes of determining income taxes for the 2007 test year will be used in calculating the interim rate increase (as it was in Interim Decision and Order No. 22050 in Docket No. 04-0113), and that the interest synchronization methodology issue will be determined by the final non-appealable decision in Docket No. 04-0113.

⁵ In Order No. 23612 filed on August 24, 2007, the commission modified the Parties' proposed Procedural Schedule by requiring the filings of proposed findings of fact and conclusions of law in lieu of opening and reply briefs. As a result, the settlement letter reflects the modified procedural steps reflected in Order No. 23612.

⁶ The Parties also have agreed on all but one issue affecting rate design. The Stipulated Settlement Letter indicates that (1) in a subsequent document, the Parties will address the issue of whether there should be a sharing of the risk associated with changes in the price of oil that is reflected in the existing Energy Cost Adjustment Clause ("ECAC"), (2) the agreement that is reflected in the Stipulated Settlement Letter is intended to provide HECO with timely rate relief through the commission's authorization of the stipulated interim rate increase, and (3) the Parties' agreement, if any, on the ECAC matter is not expected to impact the agreement on the increase to which HECO is probably entitled as set forth in the Stipulated Settlement Letter.

⁷ This provision is different from the tracking mechanism that was agreed to for the pending HELCO rate case due to different fact and circumstances. In the HELCO rate case, HELCO and the Consumer Advocate were in agreement as to the inclusion of the pension asset in rate base and the amortization of the pension asset balance at the end of the test year. In the current HECO rate case, the Parties disagree as to whether the pension asset should be included in the test year rate base, as well as whether said balance should be amortized for rate making purposes. The issue as to whether such amortization should be recognized in the test year revenue requirements has been deferred to HECO's next rate case.

In addition, under the stipulated tracking mechanism, HECO would only be required to fund the minimum level required under the law, until the existing pension asset amount is reduced to zero, at which time the Company would fund NPPC as specified in the pension tracking mechanism for HELCO. If the existing pension asset amount is not reduced to zero by the next rate case, the Parties would address the funding requirements for the pension tracking mechanism in the next rate case.

require the Company to create a regulatory asset or regulatory liability, as appropriate, for the difference between the amount of NPPC included in rates and actual NPPC recorded by the Company.

In this proceeding, HECO also proposed an OPEB tracking mechanism. HELCO and the Consumer Advocate previously agreed to the implementation of an OPEB tracking mechanism for HELCO in Docket No. 05-0315. For purposes of settlement, the Parties also have agreed to HECO's proposed OPEB tracking mechanism. The implementation of the OPEB tracking mechanism does not impact the test year revenue requirements in this case.

C.

Statement of Probable Entitlement

Pursuant to the Stipulated Settlement Letter, HECO filed a Statement of Probable Entitlement that reflects the stipulated agreements on September 6, 2007. Exhibits 1 and 2, attached to the Statement of Probable Entitlement, set forth the results of the agreement between HECO, the Consumer Advocate and the DOD on the 2007 Test Year revenue requirements ("HECO's Exhibits 1 and 2").

The Parties agree that the amount of the Interim Rate Increase to which HECO is probably entitled under HRS §269-16(d) is \$69,997,000 over revenues at current effective rates⁸ (and \$127,293,000 over revenues at present rates⁹).¹⁰

II.

Discussion

A.

Results of Operation

For interim relief purposes, the commission will apply the average test year methodology. Attached to this Interim Decision and Order are Exhibits A and B, which provide the estimates of operating revenues and expenses and the average depreciated rate base for the 2007 Test Year for purposes of this Interim Decision and Order.¹¹ These exhibits reflect the settlement between HECO, the Consumer Advocate and the DOD with respect to the issues impacting revenue requirements. In particular, the Parties have

⁸ HECO's Exhibit 1. Revenues at current effective rates are revenues from base rates plus the interim rate increase approved by the commission in Interim Decision and Order No. 22050 in HECO's 2005 test year rate case, Docket No. 04-0113, and the interim surcharge for DG trucking and fuel and LSFO trucking authorized in Order No. 23377 in Docket No. 04-0113.

⁹ HECO's Exhibit 2. Revenues at present rates are revenues from base rates, but do not include the interim rate increase and interim surcharge revenues.

¹⁰ The Parties also agree that the final rates set in Docket No. 04-0113 may impact revenues at current effective rates and at present rates, and that the amount of the stipulated interim rate increase should be adjusted when the final rates are set to take into account any such changes.

¹¹ Any differences in the commission's numbers and HECO's Exhibit 1 are due to rounding.

agreed to an increase of \$69,997,000 over current effective rates of \$1,410,457,000 or 4.96 per cent over current effective rates for a normalized 2007 test year.

The final rate of return on common equity to be adopted in this rate case will require further analysis. For purposes of this Interim Decision and Order, we accept a 10.7 per cent rate of return on common equity, for an overall rate of return of 8.62 per cent on the average depreciated rate base of \$1,158,316,000, all of which were agreed upon by the Parties. Accordingly, we conclude that interim rate relief in the amount of \$69,997,000 in additional revenues, or a 4.96 per cent increase over revenues at current effective rates, is appropriate. Based on the record, it appears that HECO will probably be entitled to the level of relief that we grant in this Interim Decision and Order. The interim relief granted meets HECO's need for immediate rate relief and protects the interests of the ratepayers.

In arriving at the interim relief for additional revenues of \$69,997,000, the commission considered the Parties' agreements and disagreements concerning the components relevant in ratemaking, namely, the test year estimates of operating revenues (at current effective rates), operating expenses, average depreciated rate base, and rate of return on average rate base. Where the Parties agreed, we accepted such agreement for purposes of this Interim Decision and Order.

B.

HECO's Requests

HECO proposes that the commission grant rate relief in two (2) steps:

1. Interim increase, equal to the increase in rates to which the commission believes HECO is "probably entitled" based on the evidentiary record before it.
2. General increase, a general rate increase when the commission issues its final decision and order to provide for the amount of HECO's total requested revenue increase not included in the interim rate increase.

HECO generally requests that its proposed rate design changes be implemented when the final increase becomes effective, at which time it will concurrently terminate the interim rate increase surcharge.

For settlement purposes, the Parties agreed to allocate any interim or final increase in electric revenues to rate classes in the percentages shown in an attachment to the Stipulated Settlement Letter, "HECO T-20, Attachment 1". According to the Stipulated Settlement Letter, this considers the positions of HECO, the Consumer Advocate, and the DOD on cost of service and movement of inter-class revenues towards the respective cost of service positions.

The Parties also agreed that Schedule P electric revenues established by this allocation will be further adjusted in the following amounts for a stipulated Schedule PP billing credit:¹² Schedule PP revenues will be decreased by approximately \$2.5 million,

¹² Per the Stipulated Settlement Letter, Schedule PP will include a billing credit of \$3.25 per billing kW for customers who are directly served from a dedicated substation. The amount of the credit is an agreed upon value to approximate the reduced level of costs that these customers impose on the HECO system. In the next HECO rate case, HECO has agreed to include in the cost of service and propose in rate design a separate rate class for customers who are directly served from a dedicated substation. The Parties

Schedule PS revenues will be increased by approximately \$2.2 million, and Schedule PT revenues will be increased by approximately \$0.3 million, as shown in HECO T-20, Attachment 1.

The Parties agreed that the effect of the stipulated revenue increase allocations, Schedule PP billing credit, and Schedule PS, Schedule PP, and Schedule PT revenue adjustments will be reflected in the approved interim rate increase as follows: Since the interim rate increase will be implemented as a percentage applied to base revenue charges, similar to the implementation of the interim rate increase approved in HECO's test year 2005 rate case, HECO will make the appropriate billing system adjustments to apply a different percentage interim rate increase to Schedule PP customers that are directly served by a dedicated substation and to those that are not, in order to implement the effect of a \$3.25 per kW credit and the stipulated revenue adjustments to Schedule PS, Schedule PP, and Schedule PT.

C.

HRS §269-16(d)

HRS §269-16(d) requires that the commission make every effort to complete its deliberations with respect to a public utility's request for a rate increase "as expeditiously as possible and before nine [(9)] months from the date the public utility filed its completed application." The statute further provides that, if such deliberations are not concluded within the nine (9)-month period, the commission shall render an interim decision within one (1) month after the expiration of the nine (9)-month period. The commission may postpone its interim rate decision an additional thirty (30) days if the commission considers the evidentiary hearing incomplete. The interim decision may allow an increase in rates if the commission believes the public utility is probably entitled" to such interim rate relief.¹³

HECO maintains that interim rate relief at this time is essential. Under the average test year concept followed in reaching the settlement, the agreed upon increase in revenues is the amount needed at the beginning of the test year to provide a reasonable opportunity to earn the fair rate of return of the test year. The later in the test year that the increase is received, the lower will be the amount of the increase actually received in the test year. In simple terms, if an annual increase of \$70 million is awarded after two-

agreed that, to manage the billing impact on Schedule PP customers, the amount of the billing credit above \$1.75 per billing kW (\$1.50 per billing kW or approximately \$2.5 million) will be recovered ratably based on billing kW from Schedule PS and Schedule PT customers.

¹³ The commission has previously determined:

[O]ur decision in this docket should be consistent with precedent and that computational errors committed by the parties should be accounted for. However, in deciding interim rate relief, the commission's scrutiny of both the record and the discourse during the evidentiary hearings is a search for showings of probable entitlement. This search is necessarily quick, unlike the careful deliberation the commission consistently accords issues in rendering final decisions. In deciding interim rate relief, the commission must often postpone determinations of reasonableness with respect to certain unresolved matters. Otherwise, the speed with which HECO is given interim rate relief would be affected.

Interim Decision and Order No. 11559, filed on March 31, 1992, in Docket No. 6998, at 7.

thirds of the 2007 test year has passed (which is the earliest that the interim increase could be made effective), then only approximately one-third of the increase (or \$23.3 million) will actually be received in 2007.

HECO also is concerned about the deterioration in its credit rating, which may make raising capital more expensive and possibly more difficult, especially in the case of preferred stock which is now non-investment grade. Recently in May 2007 Standard and Poor's ("S&P") downgraded HECO's corporate credit, unsecured debt and preferred stock ratings. This comes at a time when capital expenditures are forecast to be relatively high with anticipated increased reliance on outside capital, and when HECO needs to move forward to build the infrastructure necessary to accommodate more renewable energy.

HECO maintains that the commission has ample authority to issue an interim order at this time. For example, in HECO's 1992 test year rate case, Docket No. 6998, the commission authorized the interim increase after eight months. (Interim Decision and Order No. 11559 was filed on March 31, 1992, and HECO's application was filed on July 29, 1991.) Moreover, in this case the interim increase would be based on the amount stipulated to by the Parties for purposes of the interim. There are only two remaining contested issues, and the Parties have agreed that an evidentiary hearing is unnecessary. The first issue, interest synchronization, will be decided based on the commission's decision in HECO's 2005 test year rate case, Docket No. 04-0113. The second issue, inclusion of the pension asset and related accumulated deferred income taxes in rate base, will be briefed.

As indicated above, the interim increase that HECO is requesting is based on a calculation of probable entitlement that reflects the settlement reached by the Parties on all but two issues affecting revenue requirements. HECO notes that HRS §269-16(d) explicitly provides that the interim is subject to refund with interest. As a result, HECO's customers are protected in the event the interim is higher than the final award. The Company is not equally protected if the interim turns out to be lower than the final award. There is no retroactive increase available to the Company under that circumstance.

D.

Pension Tracking Mechanism

The Parties also agreed to a pension tracking mechanism that does not include the amortization of the pension asset as part of the tracking mechanism in this proceeding. Under the tracking mechanism, HECO would only be required to fund the minimum level required under the law, until the existing pension asset amount is reduced to zero, at which time the Company would fund the NPPC as specified in the pension tracking mechanism. If the existing pension asset amount is not reduced to zero by the next rate case, the funding requirements for the pension tracking mechanism would be addressed in the next rate case. Furthermore, the pension tracking mechanism will require the Company to create a regulatory asset or regulatory liability, as appropriate, for the difference between the amount of NPPC included in rates and actual NPPC recorded by the Company. The Parties also agreed to an OPEB tracking mechanism. In addition, the

Parties agreed to interim rates that incorporate the 2007 Test Year NPPC of \$17,711,000 and NPBC of \$6,350,000.¹⁴

E.

Interim Rates

For interim purposes, the allocation of revenue increases to the various rate classes should reflect the proposal agreed upon by the Parties and be imposed as a percentage of bill surcharge (exclusive of the energy cost adjustment clause and other surcharges), and the interim rate increase should be implemented in the manner stipulated to by the Parties.

F.

Refund

The commission emphasizes that the findings and adoption here of the various amounts reflected in Exhibits A and B are for the purpose of this Interim Decision and Order, only. Where the Parties agree, we accepted such agreement for the purposes of this Interim Decision and Order. It does not, in any way, commit the commission to accept any of these amounts in its final decision. We note that all of our decisions and rulings in this regard are subject to a more detailed review and analysis. The commission's final decision will reflect this review and analysis of all estimates and proposals of the Parties. Based on the record, it appears that HECO will probably be entitled to the level of relief that we grant in this Interim Decision and Order.

HECO will be required to refund to its customers any excess collected under this Interim Decision and Order, together with such interest as provided for by HRS §269-16 (d) , if the final increase approved by the commission is less than the total interim increase granted by this Interim Decision and Order.

III.

Ultimate Findings of Fact and Conclusions of Law

The commission makes the following findings of fact and conclusions of law.

¹⁴ See page 1 and Exhibit 2 of HECO's June 2007 Update for HECO T-12.

If the pension tracking mechanism is approved by the commission in the interim, in each future rate case, the cumulative amount of pension cost in rates since the last rate change will be compared to the cumulative amount of the actual NPPC since the rate change, and the difference will be included as a reduction to rate base (if positive, i.e., regulatory liability) or an addition to rate base (if negative, i.e., regulatory asset). The regulatory asset or liability will included in rate base and amortized over five (5) years at the time of the next rate case.

1. HRS §269-16(d) mandates the commission make every effort to complete its deliberations and issue a final decision in public utility rate cases within nine (9) months after a completed application has been filed by a utility. If such deliberations are not concluded within the nine (9)-month period, the commission shall render an interim decision within one (1) month after the expiration of the nine (9) -month period. The interim decision may be postponed an additional thirty (30) days if the commission considers the evidentiary hearing incomplete.

2. The ten (10) -month period for the issuance of an interim rate decision in this docket expires on October 22, 2007. In this case, the requested interim increase is based solely on the amount stipulated to by the Parties for purposes of the interim. There are only two remaining contested issues impacting revenue requirements, and the Parties have agreed that an evidentiary hearing is unnecessary. This Interim Decision and Order is issued in compliance with HRS §269-16(d).

3. Pursuant to HRS § 269-16(d), the commission may grant an interim increase, subject to refund and interest, pending a final decision, if the commission believes that the public utility is probably entitled to an increase in its rates.

4. Based on the evidentiary record before the commission and the Stipulated Settlement Letter, HECO is probably entitled to an increase in its rates.

5. Without interim relief, HECO may be denied an opportunity to earn a fair return on its rate base.

6. For interim decision purposes, pending a final decision in this docket, it is appropriate and reasonable to adopt an average depreciated rate base of \$1,158,316,000, a rate of return on the rate base of 8.62 per cent, and test year results of operations, as set forth in Exhibit A, which is attached to this Interim Decision and Order.

7. An interim increase in revenues of \$69,997,000, or an increase of 4.96 per cent over revenues at current effective rates, is just and reasonable.

8. Interim commission approval of the adoption of the pension and OPEB tracking mechanisms and interim rates that incorporate the 2007 Test Year NPPC of \$17,711,000 and NPBC of \$6,350,000, as agreed upon by the Parties, is just and reasonable.

IV.

Orders

THE COMMISSION ORDERS:

1. HECO may increase its rates, on an interim basis, to such levels as will produce, in the aggregate, \$69,997,000, in additional revenues for test year 2007 (4.96 per cent more than at current effective rates). The interim rate increase shall be effective from the date of this Interim Decision and Order, until the commission issues a final decision in this docket.

2. HECO may adopt the pension and OPEB tracking mechanisms and interim rates that incorporate the 2007 Test Year NPPC of \$17,711,000 and NPBC of \$6,350,000, as of the date of this Interim Decision and Order.

3. Not later than September __, 2007, HECO shall submit a revised schedule of rates and charges, reflecting the increase in rates allowed by this Interim Decision and

Order. HECO shall also serve a copy of the revised schedule upon the Consumer Advocate and the DOD.

4. Upon issuance of the final Decision and Order in this proceeding, any amount collected pursuant to this interim rate increase that is in excess of the increase determined by the final decision and order to be just and reasonable shall be refunded to HECO's ratepayers, together with interest as provided by HRS §269-16(d).